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You Cannot Fight What You Cannot See: Securities Regulation on the Internet

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Abstract

This Note suggests that the more effective resolution to regulating securities on the Internet is to look to the global nature of the medium itself and to establish an international body of law that is both uniformly understood and implemented. Part I of this Note provides background to Internet transactions and describes the traditional methods for security regulation and problems of securities fraud on the internet. Part II discusses the approaches that securities regulators are taking regarding securities fraud on the internet. Part III describes the application of conventional methods of securities regulation to Internet transactions and argues that such methods are inadequate to regulate Internet securities transactions. This Note concludes that a balance between overregulation and non-existent governance of securities transactions on the Internet is necessary and stresses the need for an international regulatory policy for conducting securities transactions on the Internet.

NOTE

YOU CANNOT FIGHT WHAT YOU CANNOT SEE: SECURITIES REGULATION ON THE INTERNET

David M. Cielusniak*

The web of our life is of a mingled yarn, good and ill together.¹

INTRODUCTION

The securities industry is often viewed as a snakepit inhabited by individuals driven by high pressure, aggressive sales tactics, and large commissions.² Technology, however, is slowly altering the balance of power.³ The Internet⁴ carries vast amounts of financial reports, projections, and advice, giving investors access to company information and the ability to choose their own investments without the coercive tactics that have made the in-

* J.D. Candidate, 1999, Fordham University School of Law. This Note is dedicated to my family for their continual support and encouragement. Special thanks to my brother for his interminable wit and humor.

1. WILLIAM SHAKESPEARE, *THE FOURTH PART OF ALL'S WELL THAT ENDS WELL* act 4, sc. 3.

2. See K. Robert Bertram, *Offers and Sales of Securities on the Internet — State Registration and Enforcement Issues* 21 (Apr. 1996) (on file with the *Fordham International Law Journal*) (stating that high-pressure tactics such as those witnessed in cold-calling may diminish as result of investing on Internet). See generally NEW YORK STATE ATTORNEY GENERAL DENNIS C. VACCO, BUREAU OF INVESTOR PROTECTION AND SECURITIES, REPORT ON MICRO-CAP STOCK FRAUD 2-3 (Dec. 1997) (describing sales tactics of securities industry).

3. See International Organization of Securities Commissions, *Report on Enforcement Issues Raised by the Increasing Use of Electronic Networks in the Securities and Futures Field* (visited Sept. 2, 1998) <http://www.iosco.org/public_docs/1997-report_on_enforcement_issues-document03.html> (on file with the *Fordham International Law Journal*) [hereinafter IOSCO] (stating that Internet has potential to transform securities industry operations); see also Bertram, *supra* note 2, at 20-21 (explaining that as securities issuers make use of Internet, high-pressure sales tactics, such as cold-calling, can potentially diminish).

4. See Bertram, *supra* note 2, at 1 n.1 (describing Internet as worldwide network of computer networks connected through telephone lines and satellite links). The Internet can be understood as an interactive medium for communication that allows for rapid and wide ranging information dissemination. *Id.* The World Wide Web ("Web") and similar proprietary and common carrier electronic systems are collectively referred to as the Internet. *Id.*

dustry infamous.⁵ As a result, the Internet may establish a link that brings greater suitability⁶ and convenience to investors at a substantially lower cost.⁷ Moreover, Internet trading obviates the need for the security industry's less reputable practices such as the cold-call⁸ and the unrelenting sales pitch.⁹

But the Internet has a dark side.¹⁰ Lurking in cyberspace is the same corruption and fraud that is found on Wall Street¹¹ and in boiler room operations.¹² Unfortunately, the Internet's impurities are difficult to control and the concomitant problems have risen to an international level.¹³ As a result, a need for a defined regulatory standard has developed.¹⁴ To this end, in the United

5. See *id.* at 21 (explaining that Internet investors can potentially avoid high-pressure sales tactics because securities issuers can market their securities through web pages instead of through broker-dealers); see also Joseph F. Cella III & John Reed Stark, *SEC Enforcement and the Internet: Meeting the Challenge of the Next Millennium, A Program for the Eagle and the Internet*, 1022 PRACTISING L. INST.: CORP. L. & PRAC. COURSE HANDBOOK SERIES 79, 81 (May 1997) (describing ease, convenience, and comprehensiveness of Internet research and investing).

6. See NORMAN S. POSER, *INTERNATIONAL SECURITIES REGULATION* 139-40 (1991) (describing suitability as maintaining appropriate investments according to customers' personal and financial situations).

7. See Leah Nathans Spiro & Linda Himelstein, *With the World Wide Web, Who Needs Wall Street?*, BUS. WK., Apr. 29, 1996, at 120 (describing small investor's transaction that would cost as much as US\$160 per trade with discount broker, now costs US\$36.50 when executed over Internet).

8. See VACCO, *supra* note 2, at 36 (describing cold-calls as "telephone calls made 'cold' to total strangers on the off chance that they may be talked into opening an account and purchasing securities").

9. See Bertram, *supra* note 2, at 21 (describing user-friendly aspects of Internet investing). For example, Internet issuers can bypass traditional distribution channels for securities; therefore, investors will not have to purchase securities through a broker and will not be subject to a broker's aggressive sales tactics. *Id.*

10. See Cella & Stark, *supra* note 5, at 83 (explaining that Internet's development has also brought opportunities for scam artists).

11. See LEWIS E. DAVIDS, *DICTIONARY OF BANKING AND FINANCE* 213 (1978) (defining Wall Street as geographic area of New York City's financial district including major banks, insurance companies, exchanges, and other financial institutions located on Wall Street and surrounding area).

12. See Jerry Knight, *The Coconuts, and Other On-Line Deals*, WASH. POST, Nov. 8, 1995, at D2 (detailing how computers enable scam artists to recycle scams from other media); see also DAVIDS, *supra* note 11, at 24 (defining boiler room operations as operations involving sales of highly speculative, and often valueless, securities by using high-pressure phone calls and misleading literature).

13. See Cella & Stark, *supra* note 5, at 100 (describing off-shore fraud and explaining that non-U.S. brokers, dealers, and investment advisors solicit U.S. investors on Internet).

14. Telephone Interview with Martin Eady, Deputy Director of Investigations, British Columbia Securities Commission (Sept. 15, 1998) (notes on file with the *Fordham*

States, federal and state government agencies have taken positions on prosecuting securities fraud over the Internet, yet agency enforcement is often done without the input, or even the approval, of any other country.¹⁵ Moreover, each U.S. state has developed its own set of regulations, which may spoil any effective and consistent governance of securities trading on the Internet.¹⁶

This Note suggests that the more effective resolution to regulating securities on the Internet is to look to the global nature of the medium itself and to establish an international body of law that is both uniformly understood and implemented.¹⁷ Part I of this Note provides background to Internet transactions and describes the traditional methods for securities regulation and problems of securities fraud on the Internet. Part II discusses the approaches that securities regulators are taking regarding securities fraud on the Internet. Part III describes the application of conventional methods of securities regulation to Internet transactions and argues that such methods are inadequate to regulate Internet securities transactions. This Note concludes that a balance between overregulation and non-existent governance of securities transactions on the Internet is necessary and stresses the need for an international regulatory policy for conducting securities transactions on the Internet.

I. BACKGROUND ON SECURITIES REGULATION ON THE INTERNET

The Internet, originally a U.S. Department of Defense project,¹⁸ is a collection of electronic networks established for com-

International Law Journal) (discussing worldwide absence of developed regulatory positions regarding securities trading on Internet).

15. See *id.*

16. See generally Jon Jefferson, *Deleting Cybercrooks: Prosecutors Want Tough Laws to Put Internet Hackers, Scam Artists and Pedophiles on Permanent Log Off*, 83 A.B.A. J. 68, 70 (1997) (describing potential burden that ensues due to creation of inconsistent laws).

17. See *id.* at 74 (discussing issues of prosecutorial reciprocity and comity coupled with conflicting cultural and political standards).

18. See Edwin Diamond et al., *The Ancient History of the Internet*, AM. HERITAGE, Oct. 1, 1995, at 34 (explaining that during Cold War, U.S. Department of Defense created agency that developed communication network for computers); see also Ari Staiman, *Shielding Internet Users from Undesirable Content: The Advantages of a PICS Based Rating System*, 20 FORDHAM INT'L L.J. 866, 871-72 (1997) (describing early history of Internet). In 1969, the U.S. Department of Defense's Advanced Research Projects Administration established a network, the ARPANet. Staiman, *supra*, at 871-72. ARPANet was capable

munication and information dissemination.¹⁹ Internet technology provides the securities industry with an attractive investment tool that is capable of reaching a global audience²⁰ and transmitting valuable information.²¹ The traditional fraudulent practices and scams of the securities industry, however, have also been adapted to the Internet.²²

A. *The Internet and Securities Regulation*

There are various ways to disseminate information on the Internet.²³ Internet technology provides investors access to current and historical information²⁴ and creates a forum for investment discussions.²⁵ In addition, the Internet allows the investor to execute securities transactions on-line.²⁶

1. The Internet: How It Works

There are essentially three methods to disseminate information electronically.²⁷ The first is the World Wide Web, a vast network of information presentations called web sites or web pages.²⁸ Web sites are generally operated by an entity or individ-

of transmitting communications between institutions conducting U.S. defense-related research. *Id.*

19. See IOSCO, *supra* note 3 (stating that Internet is umbrella term pertaining to several methods used to disseminate information electronically).

20. See *Shea ex rel. American Reporter v. Reno*, 930 F. Supp. 916, 926 (S.D.N.Y. 1996) (describing Internet users' worldwide access of information). Internet users can convey content around the world to other Internet users whom it may interest. *Id.*

21. See IOSCO, *supra* note 3 (noting benefits that Internet maintains regarding information access such as instantaneous and accurate global transmissions).

22. See Andrew Kandel, *Securities Fraud and the Internet: How New York Regulators Are Keeping Up*, WALLSTREETLAWYER.COM., Jan. 1998, at 8 (explaining how Internet presents new frontier for scam artists).

23. See IOSCO, *supra* note 3 (explaining methods by which information is disseminated on Internet such as web pages, bulletin board systems, and electronic mail).

24. See Cella & Stark, *supra* note 5, at 81 (noting array of financial statements, annual reports, earnings projections, and product information available on Internet).

25. See Gregory Spears, *The Wild, Wild Web*, KLIPLINGERS' PERS. FIN. MAG., Nov. 1996, at 60 (detailing Internet's promotional capabilities and its use as prime source for stock tips).

26. See IOSCO, *supra* note 3 (discussing Internet's increasing use for conducting market transactions and making payments for securities).

27. See *id.* (detailing collective electronic networks for communication).

28. See *id.* (describing operation of Web and noting Internet's enforcement challenges because of its ability to permit individuals to disseminate information concerning value of securities to wide audience and to offer securities for purchase or sale).

ual who determines what information appears on the web site.²⁹ Internet users access the web site's information by obtaining the site's address.³⁰

The second method for disseminating information is the bulletin board system.³¹ Also known as newsgroups or message boards, a bulletin board system is a particular location on the Internet established for users to post written messages or responses.³² These responses can be sent anonymously and can reach a global audience.³³

The third method is the electronic message, or e-mail system.³⁴ E-mail, similar to regular mail or a facsimile enables Internet users to send messages to a particular address.³⁵ E-mail is the primary use for over thirty-two percent of the thirteen million households with Internet access.³⁶ E-mail messages can also be sent as a mass mailing to numerous addresses.³⁷ Essentially, the framework of the Internet is created to communicate effectively with vast numbers of people throughout the world as well as to target specific audiences according to subject matter.³⁸

2. The Securities Industry and Internet Technology

The extensive financial information and services on the In-

29. *See id.* (noting intricacies of Web and explaining that web site content is revised and updated at discretion of web site operator).

30. *See id.* (explaining that, except for web site operator, web sites cannot be revised by Internet users but they can use web site's interactive features).

31. *See id.* (describing Internet users' ability to access information and post messages and responses through text based system).

32. *See* TRACY LAQUEY, *THE INTERNET COMPANION* 84 (1993) (describing electronic bulletin boards as similar to ordinary bulletin boards at library where information is posted for everyone to read and is taken down when no longer relevant).

33. *See* IOSCO, *supra* note 3 (describing anonymity and accessibility with message dissemination).

34. *See id.* (describing e-mail as popular and efficient means of distributing information).

35. *See* Diamond et al., *supra* note 18, at 34 (explaining that e-mail is most widely used, most convenient, and most functional of methods to disseminate information electronically).

36. *See* IOSCO, *supra* note 3 (detailing e-mail usage and growth). E-mail also presents significant challenges for regulatory agencies because messages can be anonymously transmitted to vast quantities of people. *Id.*

37. *See id.* (explaining ease of information retrieval and dissemination through e-mail communication). The mass mailing capability that e-mail provides is an attractive feature for boiler room operators that want to access a large audience quickly. *Id.*

38. *See id.* (describing expansive nature of Internet technology and noting that Internet transmits vast quantities of information accurately).

ternet to which an investor has access range from annual reports of publicly-held companies³⁹ to proxy contests⁴⁰ and takeover battles.⁴¹ The Internet's ability to disseminate information to a global audience, quickly and accurately, is a useful tool for individual investors who would otherwise be unable to collect up-to-date information.⁴² There are currently more than 1.5 million brokerage accounts on-line, and analysts expect this number to grow to 20 million by the year 2001.⁴³ Basically, the Internet is moving the securities industry away from paper-based, to electronically-transmitted, information.⁴⁴

3. Securities Trading on the Internet

The Internet can do more than display stock prices and fluctuations.⁴⁵ Investors can now execute their own trades on-line.⁴⁶ Transaction costs for these trades are less expensive than those for a traditional discount broker.⁴⁷ Moreover, Internet investing is attractive to investors because its trading markets are

39. See Donald C. Langevoort, *Information Technology and Structure of Securities Regulations*, 98 HARV. L. REV. 747, 757 (1985) (citing examples of firms offering access to securities-related information on Internet).

40. See Karen Donovan, *The Web: A Valid Proxy for Proxy-Fight Notices?*, NAT'L L.J., Jan. 29, 1996, at B1 (describing use of Internet for RJR Nabisco Holdings Corp. proxy contest).

41. See Cynthia Osterman, *Internet Used in Averting Takeover*, ORANGE COUNTY REG., Feb. 8, 1995, at C3 (describing that Slocan Forest Products Ltd. ("Slocan") fought hostile takeover bid from rival Canfor Corporation ("Canfor") by issuing detailed arguments over Internet explaining to Slocan shareholders why they should withhold their stock from Canfor).

42. See IOSCO, *supra* note 3 (explaining that individual investors may otherwise be unable to ascertain certain investment information without use of Internet).

43. See *id.* (explaining growth of Internet usage and securities industry's adoption of Internet for information and trading purposes).

44. See Langevoort, *supra* note 39, at 757-58 (stating that in relying on computer-based system, Electronic Data Gathering and Retrieval ("EDGAR"), Securities and Exchange Commission ("SEC") has begun transition from paper to electronic filing of disclosure reports required by federal securities laws).

45. See Spiro & Himelstein, *supra* note 7, at 120 (detailing opportunities for Internet investors such as access to free and inexpensive investment information, portfolio tracking services, and trade executions).

46. See *id.* (describing aspects of Internet trading and how Internet investing could fundamentally restructure brokerage business by offering less expensive and more accessible securities trading device).

47. See *id.* (explaining reasons for investor cost savings by investing on Internet). Internet brokerages keep overhead low, employ no brokers, and maintain few offices. *Id.*

available virtually twenty-four hours a day, seven days a week.⁴⁸

Internet trading also has the potential to encourage growth in small businesses.⁴⁹ For example, a Manhattan microbrewery that was too small to catch the attention of any Wall Street underwriter,⁵⁰ but did not want to resort to venture capitalists, conducted its initial public stock offering ("IPO")⁵¹ on the Internet.⁵² In February 1996, the Spring Street Brewing Company ("Spring Street"), with a little creativity,⁵³ managed to attract over 3,500 investors, to sell approximately 900,000 shares of its stock, and ultimately to raise US\$1.6 million for its business.⁵⁴

48. See *id.* (describing Internet's accessibility when traditional brokers are not available).

49. See Kerry Hannon, *Going Public to the Public*, U.S. NEWS & WORLD REP., June 17, 1996, at 74 (detailing need of Spring Street Brewing Company ("Spring Street") to expand but, as a small business, its difficulty in attaining funding).

50. See DAVIDS, *supra* note 11, at 209 (defining underwriter as someone who arranges for distribution and sale of large blocks of securities and who assumes responsibility for paying net purchase price to seller at predetermined price). In most instances the underwriter deals with a new issue of securities and with the issuing company. *Id.*

51. JEFFREY B. LITTLE & LUCIEN ROBERTS, UNDERSTANDING WALL STREET 16 (3d ed. 1991) (describing initial public offering ("IPO") as process of bringing stock issue to market for first time).

52. See Hannon, *supra* note 49, at 74 (explaining Spring Street's stock offering over Internet).

53. See *id.* (describing how Spring Street placed home page on Internet to notify public of impending sale and printed notices on six-packs of its Wit Ale with announcement urging customers to contact Spring Street for prospectus and stock order form).

54. See *id.* (explaining success of Spring Street's Internet advertising of impending IPO on Internet). U.S. regulators felt uneasy about such new-found investment capabilities, and in March 1996, Spring Street agreed to suspend its trading while the SEC researched the legal issues pertaining to on-line operations. *Id.*; see Associated Press, *Internet Trading of a Stock Is Suspended*, N.Y. TIMES, Mar. 21, 1996, at D17 (explaining that SEC questioned whether Spring Street should be registered as broker-dealer under Securities Exchange Act of 1934. The following month, the SEC allowed Spring Street to resume trading and to operate a permanent trading site so long as it took certain precautions. See Gerard R. Boyce, *Offering and Trading Securities on the Internet*, N.Y. L.J., May 9, 1996, at 5 (describing that precautions included use of escrow agent for buying and selling securities, public disclosure that Spring Street is not traded on any formal securities exchange, and requirement that Spring Street's records be made available for SEC review). Although Spring Street's IPO seemed to catch regulators off guard, the cooperation of both the issuer and the regulators enabled Spring Street to continue trading. *Id.*

One of the most important aspects of Spring Street's IPO was its use of a special exemption from formal federal registration known as Regulation A. See John C. Coffee, Jr., *Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation*, 52 BUS. LAW. 1195, 1203 (1997); Cella & Stark, *supra* note 5, at 115 n.40 (describing Regulation A Offering as IPO with total amount to be raised by offering not in excess of US\$5 million); Regulation A, 17 C.F.R. § 203.252 (1996).

Regulation A permitted general solicitation and advertising, an important pro-

But most impressively, Spring Street's IPO raised its capital without paying underwriters' or brokers' fees.⁵⁵

B. Traditional Securities Regulation

Securities regulation is created primarily for purposes of disclosing material information to the public.⁵⁶ Securities commissions and regulatory agencies, however, often exempt certain transactions or securities from disclosure requirements⁵⁷ and

vision for any issuer posting a web site on the Internet. Raising the ceiling to \$5 million dollars made Regulation A more cost-efficient, while the test-the-waters provision allowed issuers to assess the viability of an Internet securities offering prior to the commitment of substantial resources.

Stephen Knute Gregg, *Regulation A Initial Public Offerings on the Internet: A New Opportunity for Small Businesses?*, J. SMALL & EMERGING BUS. L. 417, 427 (1997). Applying Regulation A to the Internet enables issuers to contact potential investors and to test the waters before filing offering documents with the SEC. *Id.* Under normal circumstances, Spring Street would have to register with the SEC before sending such prospectuses. Christina K. McGlosson, *Who Needs Wall Street? The Dilemma of Regulating Securities Trading in Cyberspace*, 5 COMM'LAW CONCEPTUS 305, 309 (1997).

Although Regulation A seems to be a practical option for businesses wishing to issue securities on-line without the burdens of a large capital outlay and without overbearing regulations, an issuer must still register with each state if it intends to distribute offering documents to residents in that state. *Id.* Accordingly, "an issuer wanting to do a national Regulation A public offering on the Internet will have to register in fifty-one different jurisdictions." Gregg, *supra*, at 438. To comply with this procedure, Spring Street registered its offering in eighteen states and the District of Columbia and specified the states in which it was registered on all of its electronic offerings. McGlosson, *supra*, at 309. "By preempting state registration requirements, the federal government will relieve a significant regulatory burden for small businesses considering an offering over the Internet." Gregg, *supra*, at 421.

55. See Associated Press, *Firm Halts Trading Stock on Internet: Experiment Shelved Pending SEC Study*, WASH. POST, Mar. 21, 1996, at B11 (stating that after IPO, Spring Street maintained its investing operations on Internet as its stock was bought and sold through on-line bulletin boards and investor e-mail).

56. See JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 4 (2d. ed. 1997) (indicating federal approach to securities regulation is disclosure oriented); Sidley & Austin, *United States of America*, in INTERNATIONAL SECURITIES LAW 549 (1992) (explaining that Securities Act of 1933 ("1933 Act") and 1934 Act are based on theory that investors are adequately protected when all material information regarding securities is fully disclosed); Minter Ellison Morris Fletcher, *Australia*, in INTERNATIONAL SECURITIES LAW 1, 2-4 (1992) (describing securities registration process in Australia).

57. See, e.g., Securities Act of 1933, 15 U.S.C. § 77d (1997) (exempting transaction such as those not involving public offering under section 77d(2) and transactions by persons other than issuer, underwriter, or dealer under section 77d(1)); *id.* § 77c (exempting securities such as those issued by person organized and operated for religious or benevolent purposes under section 77c(a)(4) and securities issued by savings and loan association under section 77c(a)(5)); Australian Corporations Law § 1018(2), (5) (exempting securities already listed on Australian Stock Exchange).

have varying regulatory standards.⁵⁸ Organizations and international forums provide a necessary cooperation of efforts regulating the international trade of securities.⁵⁹

1. The U.S. Approach to Securities Regulation

Traditionally, the United States has subjected the securities industry to the dual jurisdiction of state and federal securities regulations.⁶⁰ Securities transactions, therefore, must comply with federal requirements⁶¹ as well as with laws of the states.⁶² U.S. courts apply federal securities laws to international transactions provided the transaction has sufficient minimum contacts⁶³ with the United States to establish subject matter jurisdiction,⁶⁴ and each party has sufficient ties to the United States for the courts to exercise personal jurisdiction.⁶⁵

58. See COX ET AL., *supra* note 56, at 349 (describing transactions and securities exempt from registration provisions of 1933 Act); Fletcher, *supra* note 56, at 2-3 (describing exemptions under Australian Corporations Law such as exemption of offers to executive officer of corporation and exemption of offers to underwriters).

59. See Kellye Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 445 ALA. L. REV. 927, 932 n. 27 (1994) (explaining that while International Organization of Securities Commissions ("IOSCO") began primarily as educational group, it has since undertaken coordination of international efforts to regulate international trade of securities).

60. See Kenneth W. Brakebill, *The Application of Securities Laws in Cyberspace: Jurisdictional and Regulatory Problems Posed by Internet Securities Transactions*, 18 HASTINGS COMM. ENT. L.J. 901, 911 (1996) (detailing U.S. regulation of securities transactions and noting that Internet brings possibility of non-U.S. government agencies claiming jurisdiction over matters traditionally considered federal or state securities agency matters).

61. See, e.g., 15 U.S.C. § 77e (defining registration requirements); Securities Exchange Act of 1934, 15 U.S.C. § 78j (1997) (regulating use of manipulative and deceptive devices in connection with purchase or sale of securities).

62. See Brakebill, *supra* note 60, at 911 (describing requirement of dual compliance with state and federal securities regulations).

63. See *Mississippi Interstate Express, Inc. v. Transportation, Inc.*, 681 F.2d 1003, 1007 (5th Cir. 1982) (establishing minimum contacts when defendant takes purposeful and affirmative action that creates business activity, foreseeable by defendant, in forum state).

64. See *Standard Oil Co. v. Montecatini Edison S.p.A.*, 342 F. Supp. 125, 129 (D. Del. 1972) (describing subject matter jurisdiction as court's general power to hear and to determine cases pertaining to general subject involved in action).

65. See *International Shoe Co. v. Washington*, 326 U.S. 310, 320 (1945) (discussing personal jurisdiction and court's power over persons with certain connections with forum state and having received formal notice through service of process); Brakebill, *supra* note 60, at 912 (detailing requirements for application of federal securities laws to transnational securities transactions).

a. Jurisdiction over Securities Transactions in the United States

U.S. courts have used expansive notions of jurisdiction when applying federal securities laws to international transactions.⁶⁶ In an attempt to limit the courts' extraterritorial powers, two tests are used to determine whether the courts can assert subject matter jurisdiction: the conduct test⁶⁷ and the effects test.⁶⁸ Satisfaction of either test will meet the requirements of subject matter jurisdiction.⁶⁹ Significant acts or conduct will establish subject matter jurisdiction under the conduct test, while any fraudulent conduct causing significant adverse effects to U.S. investors, even if the fraudulent conduct occurs predominantly in another country, will confer jurisdiction under the effects test.⁷⁰

Personal jurisdiction is established if minimum contacts toward a forum state are found to the degree that a defendant could reasonably anticipate being haled into court in such jurisdiction.⁷¹ U.S. courts continue to apply a two-prong analysis for

66. See Jill E. Fisch, *Imprudent Power: Reconsidering U.S. Regulation of Foreign Tender Offers*, 87 Nw. U. L. Rev. 523, 524 (1993) (explaining that U.S. courts apply federal securities laws to transactions with minimal U.S. contacts and that such expansive notions of jurisdiction harm U.S. participation in non-U.S. markets because of other countries' retaliatory legislation).

67. See Testy, *supra* note 59, at 933 n.34 (describing development of conduct and effects tests as "harken[ing] to antitrust law, which may have been genesis of these lines of [subject matter jurisdiction] cases"); *American Banana Co. v. United Fruit Co.*, 213 U.S. 347, 356 (1909) (explaining conduct approach and recognizing that character of act as lawful or unlawful is determined by law of country where act is committed).

68. See, e.g., *United States v. Sisal Sales Corp.*, 274 U.S. 268, 276 (1927) (using effects test for applicability of U.S. antitrust laws); *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 444 (2d Cir. 1945) (addressing and maintaining effects test jurisprudence). In his opinion in *United States v. Aluminum Co. of Am.*, Judge Learned Hand states that agreements, though made abroad, are unlawful if they are intended to affect imports to United States. 148 F.2d at 444.

69. See Testy, *supra* note 59, at 933 n.34 (discussing that series of cases in Second Circuit in early 1970s attempted to limit extraterritorial application of antifraud provisions by developing conduct test and effects test).

70. See *id.* at 913 (explaining that effects test is broader than conduct test and is easily expanded by globally interconnected markets).

71. See Joan C. Henry, *Establishing Personal Jurisdiction for Internet Transactions* 3-4 (1997) (addressing personal jurisdiction cases and application of two-prong analysis concerning state statutes and Due Process Clause) (on file with the *Fordham International Law Journal*); see also *Asahi Metal Indus. Co. v. Superior Court*, 480 U.S. 102, 105 (1987) (addressing issue of whether foreign defendant's knowledge that components that it manufactured, sold, and delivered outside United States would reach forum state in stream of commerce constituting minimum contacts); *Burger King Corp. v.*

determining whether personal jurisdiction comports with the Due Process Clause of the Fourteenth Amendment.⁷² According to the analysis, for courts to assert personal jurisdiction over a defendant, the defendant must have established minimum contacts in the forum state.⁷³ In addition, the exercise of personal jurisdiction must not offend traditional notions of fair play and substantial justice.⁷⁴

Personal jurisdiction over a non-U.S. defendant requires more than mere placement of a product into the stream of commerce.⁷⁵ Additional conduct must be shown to prove that the defendant intended to service the market in the forum state.⁷⁶ Without the showing of such purposeful availment, exercising personal jurisdiction is beyond the limitation of the Due Process Clause.⁷⁷

b. Regulation of Securities Transactions in the United States

During the late-nineteenth century, U.S. states began enacting legislation designed to prevent securities fraud.⁷⁸ These laws required issuers to disclose information concerning securities of-

Rudzewicz, 471 U.S. 462, 462 (1985) (discussing forum selection clause in franchise contract between individual franchisee in Michigan and franchisor corporation in Florida); *Worldwide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 287 (1980) (addressing issue of whether Oklahoma court can exercise personal jurisdiction over non-resident automobile retailer and wholesale distributor in product liability action).

72. See *Burger King Corp.*, 471 U.S. at 471-72 (explaining that Due Process Clause protects person's liberty interest by preventing binding judgments against someone who has no meaningful ties or contacts within forum); U.S. CONST. amend. XIV § 1 (guaranteeing procedural fairness where government would deprive person's property or liberty).

73. See *Burger King Corp.*, 471 U.S. at 474 (noting that constitutional touchstone depends on whether defendant established minimum contacts).

74. See *id.* at 476 (explaining that once it is determined that defendant established minimum contacts, such contacts, along with other factors, determine whether assertion of personal jurisdiction comports with fair play and substantial justice).

75. See *Asahi*, 480 U.S. at 110 (noting that defendant's awareness that stream of commerce can bring product to forum state is not purposeful availment for sufficient personal jurisdiction).

76. See *id.* at 112 (explaining that defendant had not anticipated sales in forum state).

77. See *id.* at 112-13 (finding that Japanese manufacturer did not do business, advertise, solicit, or otherwise demonstrate any action to purposefully avail itself to the forum states' market).

78. See *Sidley & Austin*, *supra* note 56, at 549 (explaining that state regulations governing securities, also known as blue sky laws, focused on regulating fraudulently valued securities).

ferings.⁷⁹ Securities regulation on the state level, however, proved inadequate. Consequently, a federal regulatory system was created.⁸⁰

i. State Regulation of Securities

Regulatory systems vary by state.⁸¹ Some states require approval from a state agency that conditions an issuer's permit to sell securities.⁸² There are also states that broadly prohibit fraud or misrepresentation pertaining to the purchase and sale of securities.⁸³ Other states simply permit securities to be issued in the state without further processing, provided that the issuer is registered under the federal laws.⁸⁴

ii. Federal Regulation of Securities

In the wake of the 1929 stock market crash,⁸⁵ the U.S. Congress created a federal regulatory system for the securities industry.⁸⁶ The Securities Act of 1933⁸⁷ ("1933 Act") and the Securities Exchange Act of 1934⁸⁸ ("1934 Act") are the two principal

79. *See id.* (describing history of information disclosure requirements in state regulatory systems).

80. *See id.* (explaining insufficiency of state regulatory system prompting federal regulation).

81. *See id.* (detailing requirements for state registration).

82. *See* COX ET AL., *supra* note 56, at 17 (describing that many state regulators have broad authority to deny and to condition issuer permits).

83. *See, e.g.*, N.Y. GEN. BUS. § 359-e(3), (8) (McKinney 1994); 2 Blue Sky L. Rep. (CCH) ¶ 42,111. The Martin Act, New York's Blue Sky Laws, was adopted to protect public against exploitation by visionary schemes and fraudulent practices pertaining to securities. *People v. Concord Fabrics, Inc.*, 371 N.Y.S. 2d 550, 553 (N.Y. Sup. Ct. Spec. Term 1975).

84. *See, e.g.*, *Data Access Systems, Inc. v. Bureau of Securities*, 305 A.2d 427, 433 (N.J. 1973) (determining that New Jersey statute makes no review provision for offering registration with SEC).

85. *See* KENNETH W. CLARKSON ET AL., *WEST'S BUSINESS LAW* 860 (6th ed. 1995) (noting that stock market crash of October 29, 1929 and economic depression that followed brought public to focus on importance of securities markets for economic success of nation). Reports describing the speculative and manipulative trading practices during the decade preceding the crash were circulated. *Id.* Such practices outraged the public and Congressional action was requested. *Id.* In 1931, the U.S. Senate passed a resolution calling for an extensive investigation of securities trading. *Id.* The investigation ultimately led to the passage of the 1933 Act. *Id.*

86. *See* Sidley & Austin, *supra* note 56, at 549 (describing events leading to federal securities legislation and regulatory system).

87. 15 U.S.C. §§ 77a-77aa (1997).

88. 15 U.S.C. §§ 78a-78ll (1997).

federal statutes governing securities transactions.⁸⁹ Both the 1933 Act and the 1934 Act are premised on the concept of information disclosure and the idea that adequate investor protection occurs when all material information is made available to the investor.⁹⁰

The 1933 Act primarily addresses securities distribution,⁹¹ the regulation of public offerings, and the sale of securities in interstate commerce.⁹² The 1934 Act covers aspects of securities trading and establishes the Securities and Exchange Commission ("SEC").⁹³ Concerned mainly with the integrity of the marketplace, the 1934 Act's primary purpose is stock market regulation.⁹⁴ The SEC is responsible for the overall administration of the disclosure requirements under the federal securities laws,⁹⁵ the regulation of secondary trading markets,⁹⁶ and the investigation and prosecution of those who violate the federal securities laws.⁹⁷ The SEC's broad power essentially expands and refines the securities laws through its enforcement actions and legal theories under which such actions are maintained.⁹⁸

2. The Australian Approach to Securities Regulation

The Australian Corporations Law regulates the Australian

89. See Sidley & Austin, *supra* note 56, at 549 (explaining structure of federal securities regulation).

90. See *id.* (detailing purpose of 1933 Act and 1934 Act).

91. 15 U.S.C. § 77(e) (explaining registration requirements and prohibitions regarding interstate commerce and mails); see Sidley & Austin, *supra* note 56, at 549 (explaining structure of 1933 Act).

92. 15 U.S.C. § 77(e); see COX ET AL., *supra* note 56, at 3 (describing 1933 Act's regulatory scope).

93. 15 U.S.C. § 78d(a) (1997).

94. *Id.* § 78b (explaining breadth of regulation and control of 1934 Act).

95. *Id.* § 78l.

96. *Id.* § 78b; see LITTLE & ROBERTS, *supra* note 51, at 24-25 (explaining that investors' main contact in secondary market is their broker and that shares are traded according to supply and demand).

97. 15 U.S.C. § 78u; see COX ET AL., *supra* note 56, at 11 (describing four divisions of SEC: Division of Corporate Finance, which is responsible for reviewing registration requirements, Division of Market Regulation, which oversees secondary trading markets, Division of Investment Management, which administers Investment Company Act and Investment Advisors Act, and Enforcement Division, which is responsible for investigations and prosecutions).

98. 15 U.S.C. § 78u (defining scope of SEC's investigations and actions proceedings); see COX ET AL., *supra* note 56, at 11 (describing functions of SEC divisions).

securities industry.⁹⁹ The Corporations Law, contained in Section 82 of the Corporations Act of 1989,¹⁰⁰ acts as a single national law¹⁰¹ and regulates both new issues and secondary trading of securities.¹⁰² The Australian Securities and Investments Commission¹⁰³ ("ASIC") administers the Corporations Law.¹⁰⁴ To avoid overburdening or harsh applications of the Corporations Law, the ASIC has the discretionary power to waive or to modify the Corporations Law's requirements and conditions.¹⁰⁵

3. The International Organization of Securities Commissions

The International Organization of Securities Commissions¹⁰⁶ ("IOSCO") consists of representatives from over 100 securities regulators from around the world.¹⁰⁷ IOSCO is the predominant international forum for securities regulators and includes regulators from developed as well as emerging markets.¹⁰⁸ IOSCO announces recommendations and sets guidelines for adoption in each IOSCO jurisdiction.¹⁰⁹ IOSCO'S announce-

99. See Fletcher, *supra* note 56, at 1 (explaining formation of regulatory structure of Australian securities).

100. Corporations Act, 1989, § 82 (Austl.).

101. See Fletcher, *supra* note 56, at 1 (explaining that Australian Corporations Act of 1989 applies Corporations Law as law of Australian Capital Territory and that each state as well as Northern Territory passed an Application Act, which applies Corporations Law as law of that state or territory; therefore, it essentially operates as single national law).

102. See *id.* at 2 (detailing scope of Australian Corporations Law and its broad prohibition of securities offerings without filing prospectus).

103. See *Welcome to the Australian Securities & Investments Commission—more than a corporate watchdog: What's New* (visited Sept. 28, 1998) <<http://www.asic.gov.au/page-0.html>> (on file with the *Fordham International Law Journal*) (explaining that on July 1, 1998, Australian Securities Commission changed its name to Australian Securities and Investments Commission ("ASIC")).

104. See Fletcher, *supra* note 56, at 1 (describing structure and administration of Australian Corporations Law).

105. See *id.* at 1-2 (explaining ASIC's powers to administer the Australian Corporations Law and to grant licenses to securities dealers and investment advisors).

106. See Testy, *supra* note 59, at 932 n.27 (explaining that IOSCO was formed in 1970s to facilitate discussion among securities regulators from different countries).

107. See David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, 33 TEX. INT'L L.J. 281, 282 (1998) (describing IOSCO and international financial organizations assisting in international regulatory cooperation).

108. See *The SEC Speaks in 1998: International Developments*, 1307 PRACTISING L. INST.: CORP. L. & PRAC. COURSE HANDBOOK SERIES 149, 167 (Feb. 1998) (detailing international initiatives and organizations).

109. See *id.* (describing IOSCO's functions such as defining methodologies for

ments pertain to international disclosure requirements, record-keeping and accounting standards, information collection and sharing, and enforcement powers.¹¹⁰

C. Securities Fraud on the Internet

"In my 32 years of investigating fraud, this is by far the greatest money-making machine for scammers that I have ever seen."¹¹¹

The Internet is a new medium through which investors may trade securities, but it also is a new medium through which investors can be victims of fraud.¹¹² Internet trading, thus, presents a dichotomy. Not only does it provide unlimited access to information and, thus, help investors make wiser decisions, but also it provides a new medium to set up fraudulent schemes and to spread misinformation.¹¹³

1. The Problem of Anonymity on the Internet

The Internet appeals to the investor because its news is not only more recent than the morning's paper, but it also is more easily ascertainable for trades, confirmations, and updates.¹¹⁴ Unfortunately, for many on-line investors not everything they access on the Internet is truthful.¹¹⁵ One of the biggest obstacles facing securities regulators regarding the Internet is the ano-

minimum capital standards and supervisory approaches to systems and controls for internationally active securities firms).

110. See *id.* at 167-68 (explaining IOSCO's projects and recommendations such as developing standards for non-financial statement disclosures in cross-border offerings and establishing Internet Task Force).

111. See NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., CYBERSPACE FRAUD AND THE SMALL INVESTOR (on file with the *Fordham International Law Journal*) (quoting veteran state security agency official regarding new opportunities for fraud with Internet).

112. See Kandel, *supra* note 22, at 8 (noting that Internet is new medium for legitimate means of raising capital, but scam artists can use Internet for pyramid schemes and unregistered securities offerings).

113. See Greg Miller & Tom Petruno, *Net's Growing Power over Markets*, NEWSDAY, June 5, 1996, at A53 (describing Internet as new medium for valuable information and for fraudulent investments and securities price manipulation).

114. See *id.* (explaining that Internet gives investors opportunity to make wiser decisions because of increased accessibility to information).

115. See *id.* (noting that Internet gives scam artists new supply of targets for their investment schemes).

nymity of various communications.¹¹⁶ Stock tips that would formerly be exchanged at cocktail parties are now exchanged on-line.¹¹⁷ Therefore, the reliability of on-line information is more difficult to measure.¹¹⁸ Even with the boiler room brokerages there were physical locations to trace, but on-line fraud is more difficult to monitor and often impossible to track down and to find the culprit.¹¹⁹ When regulators are unable to discover who creates the fraud, or from where it originates, successful prosecutions become difficult.¹²⁰ Furthermore, offshore web sites are often beyond the reach of U.S. regulators.¹²¹ In many respects, the Internet is a sign that science has outwitted the art of governance.¹²²

2. Securities Fraud on the Internet

Although investors can use the Internet as a place for obtaining information, advice, and opportunities, it has also become a new medium for fraud.¹²³ By some estimates, Internet investors are defrauded of over US\$100 million per year.¹²⁴ For

116. See Spears, *supra* note 25, at 60 (stating investor on Internet does not know from whom investment advice is obtained).

117. See *id.* (explaining that investors are looking to Internet bulletin boards, web sites, and e-mail for stock information and recommendations).

118. See Miller & Petruno, *supra* note 113, at A53 (explaining that over Internet, "it can be hard to tell whether you're getting a recommendation from a broker, a short seller, or an antisocial 20-year-old").

119. See Knight, *supra* note 12, at D2 (interviewing Denny Crawford, Texas Commissioner of Securities, addressing difficulty of locating point of origin of e-mail messages and anticipating increase in stock price manipulation and sale of non-existent shares on Internet); Coffee, *supra* note 54, at 1224 (explaining that neither SEC nor National Association of Securities Dealers ("NASD") has regulatory authority over investors wishing to post anonymous comments in Internet chat rooms, nor can either agency detect whether broker-dealers are behind posted rumors).

120. See Nikki Tait & Paul Taylor, *Australian Watchdog Issues: Internet Share Warning*, TODAY'S FIN. TIMES, June 20, 1996 (explaining difficulty of successful prosecutions because Internet messages cannot be easily traced).

121. See Miller & Petruno, *supra* note 113, at A51 (describing amorphous nature of Internet).

122. See Catherine Yang, *Law Creeps onto the Lawless Net*, BUS. WK., May 6, 1996, at 58 (describing regulators' lack of control over Internet); Bertram, *supra* note 2, at 2 n.4 (explaining that it is inconceivable to suggest that drafters of securities laws were able to envision Internet securities transactions).

123. See Miller & Petruno, *supra* note 113, at A53 (explaining that securities regulators are overwhelmed by new opportunities for con artists on Internet).

124. See Don McLeod, *Cyberfraud: High-Tech Scams on the Internet*, AARP BULLETIN, July-Aug. 1996, at 15 (explaining that number of Internet victims will grow because enforcement agencies are slow to react).

a variety of reasons, the Internet provides an ideal setting for fraud.¹²⁵ The cost of setting up an Internet web page is decreasing, as is the cost for an investor to access the Internet.¹²⁶ Both of these aspects, together, lower the barriers to entry, and the Internet becomes a much less expensive way for scam artists to find victims than by using traditional techniques such as mass mailing and cold-calling.¹²⁷

As Internet usage increases and the Internet is accepted as a legitimate tool in the securities industry, investors may also encounter its dark side.¹²⁸ The tricks and traps that are used to dupe Internet investors, however, are nothing new. In fact, Internet scam artists are recycling scams previously used in other media.¹²⁹ The largest problem for regulators is the Internet's ability to hide one's identity and to enable scam artists to appear and to disappear easily on-line.¹³⁰ Essentially, a get-rich-quick scam necessitates only a modem and a mailing list.¹³¹

Investors who cannot distinguish between amateur and professional web sites will undoubtedly have a more difficult time determining the legitimate from the fraudulent.¹³² The success of Internet scams is partly due to the fact that the securities in-

125. See *Businesses Promote Fraud Tools on Internet; Web Shows How to Hide One's Identity, Use Offshore Accounts for Secret Stocks*, AUSTIN AM. STATESMAN, July 15, 1996 (quoting Robert Bertram, chairman of Internet fraud committee of North American Securities Administrators Association ("NASAA"), discussing scam artists easy adaptation to Internet technology).

126. See Christopher Wolf & Scott Shorr, *Cybercops Are Cracking Down on Internet Fraud*, NAT'L L.J., Jan. 13, 1997, at B12 (describing increasing ease of Internet access due to decreasing costs of advertising and promoting along with decreasing cost of consumer access).

127. See Kandel, *supra* note 22, at 8 (explaining Internet's ability to reach mass audience).

128. See Cella & Stark, *supra* note 5, at 83 (explaining that scam artists will also take advantage of Internet technology).

129. See McLeod, *supra* note 124, at 15 (describing scam artists' adaptation of pyramid schemes to Internet technology).

130. See *id.* (discussing anonymity on Internet and problems lack of identity creates for enforcement agencies face when attempting to investigate Internet fraud).

131. See Knight, *supra* note 12, at D2 (explaining that Internet connection enables advertisement to reach hundreds of thousands of people and that scam artist need only lure few investors to make profitable investment scheme). David Menlow, president of IPO Financial Network, said that "[i]f you have an Internet connection and can get your ads out and hundreds of thousands of people read it, all you need is a few to make money." *Id.*

132. See *id.* (explaining that high-tech communication such as Internet provides credibility to investment schemes).

dustry is driven by to-the-second information that often gives investors an advantage.¹³³ For example, investor chat-rooms are an instant source of small stock speculation.¹³⁴ Unfortunately, information such as on-line newsletters may be nothing short of an elaborate advertisement for a scam artists' investment scheme.¹³⁵ In essence, to the horror of regulators, the Internet has become the modernized version of the boiler room.¹³⁶

The cause for this alarm is the sheer prolific nature of Internet schemes.¹³⁷ Brokers are no longer hampered by hours of telephone calls and sales pitches.¹³⁸ Scam artists can, instead, pay approximately US\$20 per month to an Internet service provider, create a single sales pitch, and with a click of the mouse, send the information to hundreds of thousands of people around the globe.¹³⁹ As a result, the Internet enables a typical boiler room broker, who would normally only make approximately 150 cold-call stock pitches per day, to contact thousands of individuals each minute.¹⁴⁰

As mentioned earlier, virtually all of the old telemarketing scams are used on-line.¹⁴¹ One of the major advantages that the Internet provides the scam artists, however, is its user-friendly atmosphere.¹⁴² Developing a fraudulent web page is not only an

133. See Miller & Petrino, *supra* note 113, at A53 (stating that Internet investors gain access to information allowing them to make wiser decisions).

134. See *id.* (explaining that Internet chat-room conversations are sometimes attempts by brokers to manipulate securities markets).

135. See Gary Weiss, *The Hustlers Queue Up on the Net*, Bus. Wk., Nov. 20, 1995, at 146 (detailing various scams conducted on Internet).

136. See *id.* (noting that on-line stock promotions by people owning shares and then selling when prices rises is high-tech version of boiler room operations).

137. See *id.* (explaining that ease of gaining Internet access facilitates growth of on-line investment schemes).

138. See NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., *supra* note 111 (noting that Internet access provides enormous advance in scam artists' ability to develop investment schemes).

139. See Weiss, *supra* note 135, at 146 (explaining that traditional brokers spend hours making telephone calls in order to promote stock, but Internet gives brokers opportunity to promote stock to global audience by creating one message).

140. See NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., *supra* note 111 (describing efficiency of Internet mailings and Internet's advance in sales marketing).

141. See McLeod, *supra* note 124, at 15 (noting Internet scams such as pyramid schemes and fraudulent investments are recycled from other media).

142. See Cella & Stark, *supra* note 5, at 82-83 (describing that decreasing start-up costs and growing popularity of bulletin board systems produces additional opportunities for fraud-artists).

easy scam that can be created from the comforts of any home, with very little cost or operational overhead, but also it is an effective way for victims unintentionally to seek out the scam artist.¹⁴³ To make the scam more convincing, anyone setting up a web site can develop, with little effort, a site that looks as sophisticated as, or better than, the site of any Fortune 500¹⁴⁴ company.¹⁴⁵

A common investment tactic of a scam artist is to develop an elaborate home page to reassure prospective investors that the scam artist's investment opportunity is legitimate.¹⁴⁶ Oftentimes, the scam artist's home page provides hypertext¹⁴⁷ to the home page of a regulatory agency to imply falsely that the particular security or investment is approved by the regulators.¹⁴⁸ A variation of the false reassurance includes hypertext to a newsletter that is praising the investment.¹⁴⁹ As a suspecting eye may now imagine, however, the hypertext is also owned and operated by the scam artist.¹⁵⁰

Another popular method of defrauding Internet investors is the pump and dump technique.¹⁵¹ The pump and dump scam begins with stock promoters¹⁵² entering chat¹⁵³ rooms where in-

143. See *id.* (detailing how investors access investment web pages and use Internet as investment resource).

144. See MICHAEL C. THOMSETT, *INVESTMENT AND SECURITIES DICTIONARY* 115 (1986) (defining Fortune 500 as "an index published by Fortune Magazine, rating the top 500 corporations in the United States, in terms of net income, total sales, and stockholders' equity").

145. See Cella & Stark, *supra* note 5, at 88 (describing web pages promoting fraudulent investments that are thoroughly convincing).

146. See *id.* (noting that low cost and relative ease of creating web site enables scam artist to construct convincing investment scheme).

147. See VALERIE QUERCIA, *INTERNET IN A NUTSHELL: A DESKTOP REFERENCE* 407 (1997) (defining hypertext as "[d]ocuments that contain links to other documents; selecting a link automatically displays the second document").

148. See Cella & Stark, *supra* note 5, at 88 (detailing Internet investment scam).

149. See *id.* (describing ways in which scam artist produces web site depicting tremendous investment opportunity).

150. See Noelle Knox, *Fraud Rises Along with Dow: Unscrupulous Brokers Cheat Their Customers*, *FLORIDA TODAY*, Sept. 4, 1997, at 12C (explaining that regulators find scam artists in chat rooms pretending to be sophisticated investors talking about great investment opportunities).

151. See *id.* (describing that Internet created new circuit for fraudulent practices).

152. See DAVIDS, *supra* note 11, at 167 (defining promoter as middleman, typically associated with new firm, bringing together necessary factors of business venture).

153. See QUERCIA, *supra* note 147, at 406 (defining chat as "real-time conversation (in text, usually) among multiple users on-line" and explaining that "[d]iscussions take place in virtual rooms or channels").

vestors are discussing their market intuitions.¹⁵⁴ These promoters then encourage purchasing a stock that they actually own by stating that they have inside information or some late-breaking news pertaining to the company.¹⁵⁵ The promoters then wait for the word to spread and for individuals to invest.¹⁵⁶ Finally, the promoters sell the shares that they held while the stock price was artificially inflated by their rumors.¹⁵⁷ This technique is often equated with practices in boiler rooms, where the brokers are the market-makers for their firm's stocks and manipulate the stock price to the detriment of the clients and for the benefit of themselves.¹⁵⁸

The Internet provides scam artists with an array of advantages such as the ability to identify consumer Internet activity, low operating costs, anonymity, and instant access to a global market for conducting investment schemes.¹⁵⁹ Scam artists often make claims that they have visited the companies, inspected the operations, or conversed with company personnel to convince the investor that their information is legitimate.¹⁶⁰ Even in the unlikely event that the investor researches the scam artist's claim, the individual who is telling the information to the investor is most likely unidentifiable.¹⁶¹ For example, investment schemes often hype mining expeditions and factories in remote portions of the world making it virtually impossible for

154. See Spears, *supra* note 25, at 60 (explaining that Internet is replacing cocktail party as prime source for hot stock tips).

155. See *id. passim* (describing characteristics of fraudulent investment opportunities such as exaggerated claims of profit, offers of inside information, and promotions of exotic investments).

156. See *id.* at 60 (describing fraudulent promotions and false rumors spread on Internet).

157. See Weiss, *supra* note 135, at 146 (describing how brokers and corporate insiders use Internet to tout stock that they are trying to unload).

158. See *id.* (explaining that pump and dump scam on Internet is high-tech recycling of boiler room version).

159. See FEDERAL TRADE COMMISSION ANTITRUST AND TRADE REGULATION REPORT, ANTICIPATING THE 21ST CENTURY: CONSUMER POLICY IN THE NEW HIGH-TECH at S-3 (May 1996) (noting Internet's global outreach and describing how Internet technology allows scam artists to operate easily and inexpensively anywhere in world).

160. See NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., *supra* note 111 (advising Internet investors to refrain from assuming that research and inspections have been conducted).

161. See *id.* (addressing problem with anonymity over Internet and inability to verify legitimacy of investment opportunity).

the investor to visit or to research the operations.¹⁶²

II. CURRENT ATTEMPTS TO REGULATE SECURITIES ON THE INTERNET

"We're not looking to prevent the Internet as a legitimate way of raising capital, but we are trying to insure that those who seek to use this medium comply with the appropriate laws and regulations."¹⁶³

The global nature of the Internet also raises new concerns regarding choice of law.¹⁶⁴ Enforcement agencies must confront local laws in foreign countries that often do not consider Internet fraud an illegal act.¹⁶⁵ Aside from the United States, few countries have developed a regulatory framework or an established position that addresses securities on the Internet.¹⁶⁶

A. Current U.S. Approach to Regulating Securities Transactions on the Internet

The basic framework of U.S. securities regulation is premised upon geographical boundaries,¹⁶⁷ but the Internet is a medium that recognizes neither state nor national boundaries.¹⁶⁸ Although state and federal regulators in the United States believe that committing fraud on the Internet breaks the

162. See *id.* (describing Internet scam artist tactics and false claims of events and business operations).

163. See David Chen, *Two States Investigate Film Company's On-Line Request for Investors*, N.Y. TIMES, May 12, 1997, at D8 (quoting Andrew Kandel, Chief of New York State Attorney General's Investor Protection and Securities Bureau, addressing regulators encouraging, but cautious, position regarding Internet securities transactions).

164. See *Anticipating the 21st Century: Consumer Protection Policy in the New High-Tech Marketplace*, *supra* note 159, at S-5; see also BLACK'S LAW DICTIONARY 241 (6th ed. 1990) (defining choice of law as "the question presented in determining what law should govern"); Henry H. Perritt, Jr., *Jurisdiction in Cyberspace*, 41 VILL. L. REV. 1 (1996) (explaining that transnational nature of Internet increases frequency with which choice of law questions arise).

165. See McLeod, *supra* note 124, at 15 (explaining reasons for sluggish enforcement regarding Internet fraud).

166. See Martin Eady, *From Bay Street to the Information Superhighway*, Eighth Annual Securities Superconference – Toronto, Feb. 23, 1998, at 1 (stating that SEC "has been the leader in adopting regulatory responses to the Internet"); see also Telephone Interview with Martin Eady, *supra* note 14.

167. See Bertram, *supra* note 2, at 1 (discussing application of regulatory frameworks based on state or national boundaries to Internet).

168. See *id.* (explaining that Internet is forcing regulators to re-evaluate existing laws because of Internet's lack of boundaries).

same laws as committing fraud in any medium,¹⁶⁹ enforcement is difficult,¹⁷⁰ partly because of the jurisdictional hurdles that regulators must surpass.¹⁷¹

1. U.S. Jurisdiction over Internet Transactions

In the United States, the question remains whether conventional rules of civil procedure are suitable to establish jurisdiction over Internet activities.¹⁷² Internet messages that can be sent or received anywhere in the world may not trigger subject matter jurisdiction under the effects test.¹⁷³ Furthermore, until conduct can be defined for Internet transactions, the conduct test cannot be applied to the Internet.¹⁷⁴ As for personal jurisdiction, foreseeability does not sufficiently establish jurisdiction over a foreign defendant;¹⁷⁵ additional conduct beyond the mere placement of a web site on the Internet is necessary.¹⁷⁶

Experts suggest that the Internet requires a re-examination of the historical view of physical locales as the basis for jurisdiction.¹⁷⁷ Traditionally, the law establishes location with geographical boundaries,¹⁷⁸ but the structure of the Internet may make federal securities laws obsolete.¹⁷⁹ A current, prominent question is whether the physical place where a web page is created and maintained has exclusive jurisdiction, or whether regu-

169. See Coffee, *supra* note 54, at 1199 (explaining that fraud remains fraud, regardless of medium of communication).

170. See McLeod, *supra* note 124, at 15 (describing regulators' burdensome task of regulating Internet).

171. See Bertram, *supra* note 2, at 15-16 (discussing statutory and regulatory changes necessary for regulating Internet).

172. See Brakebill, *supra* note 60, at 924 (stating that defendant committing securities fraud through use of Internet possesses more attenuated connections with forum state than defendants in similar situations without use of Internet).

173. See *id.* at 925 (noting that potential for reliance upon Internet message by U.S. investor is generally insufficient to support assertion of U.S. jurisdiction).

174. See *id.* at 924 (discussing importance of defining where act occurs).

175. See *id.* (addressing placement of fraudulent offering statements on Internet).

176. See *id.* at 925-26 (explaining deficiencies in applying established jurisdictional tests to Internet transactions).

177. See Harley J. Goldstein, *On-Line Gambling: Down to the Wire?*, 9 MARQ. SPORTS L.J. 1, 1 (1997) (expressing need to reclassify frameworks to encompass changes brought by Internet technology).

178. See *id.* (explaining that as result of Internet technology, laws can no longer adequately address location by referring to geographical boundaries).

179. See Coffee, *supra* note 54, at 1199 (explaining how Internet does not fit within concepts known to federal securities laws).

latory power extends' to where the site can be viewed.¹⁸⁰ Personal jurisdiction remains hinged upon contacts with a forum state.¹⁸¹ Internet technology, however, has altered the nature of what contacts really are.¹⁸²

2. U.S. Regulation of Securities Transactions on the Internet

Offers and sales of securities over the Internet must still comply with federal securities laws as well as state blue sky laws.¹⁸³ The SEC believes that new laws are not needed and that only evolution of the old laws is necessary to combat Internet fraud.¹⁸⁴ Many state regulators have shown concern regarding the Internet's lack of geographical limitations and believe that new legislation is required.¹⁸⁵

a. U.S. Federal Regulation of Internet Securities

Although the SEC and the North American Securities Administrators Association¹⁸⁶ ("NASAA") have set up Internet surveillance programs,¹⁸⁷ some regulators feel that policing the Internet is not effective and is simply an inefficient and unrealistic method of deterring Internet fraud.¹⁸⁸ In addition, other en-

180. See Wolf & Shorr, *supra* note 126, at B12 (describing worldwide assertion of jurisdiction and regulatory control over Internet content).

181. See BLACK'S LAW DICTIONARY, *supra* note 164, at 655 (defining forum as "[p]articular place where judicial or administrative remedy is pursued").

182. See Hon. Gregory Kellam Scott, *Professional Ethics and the Internet*, 1022 PRACTISING L. INST.: CORP. L. & PRAC. COURSE HANDBOOK SERIES 325, 333 (Nov. 1997) (addressing courts' adoption of expansive view of minimum contacts when deciding Internet-related issues).

183. See Boyce, *supra* note 54, at 5 (explaining that although Internet securities offerings and trading provide new opportunities for small companies, company executives and attorneys should recognize that Internet does not alleviate requirement of U.S. state and federal securities law compliance).

184. See Cella & Stark, *supra* note 5, at 101 (stating that antifraud provisions of section 10(b) of Exchange Act, 15 U.S.C. § 78j(b) (1997), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1996), apply to any fraudulent communication on Internet, as they would to any information communicated on paper, radio, or television).

185. See generally Bertram, *supra* note 2, at 3 (detailing state rulemaking in response to Internet transactions).

186. See THOMSETT, *supra* note 144, at 190 (defining NASAA as "an association of the [U.S.] state securities agencies, also including membership from some Canadian provinces").

187. See Sarah Stirland, *News and Trends: Securities Regulators Prowl the Net, Looking for Lawbreakers*, BOND BUYER, Nov. 13, 1996 (describing regulators' surveillance efforts such as active patrolling Internet web pages and examining bulletin board messages).

188. See *Businesses Promote Fraud Tools on Internet; Web Shows How to Hide One's Identi-*

forcement agencies are asserting their ability to regulate the Internet.¹⁸⁹ For example, the Federal Trade Commission¹⁹⁰ ("FTC") has taken the position that it can prosecute those who sell products on-line for failure to adhere to the federal fraud and truth-in-advertising regulations that govern other media.¹⁹¹ State and federal regulatory agencies have similarly expressed confidence in existing mail and wire-fraud laws to govern the Internet.¹⁹²

The SEC has not sought any new statutes, regulations, or rules pertaining to Internet investor protection.¹⁹³ The SEC takes the position that U.S. Congressional intervention is unnecessary because Internet fraud is simply the regeneration of old scams in a new medium and although the Internet offers scam artists a new tool, it does not necessitate new securities laws and regulations.¹⁹⁴ The SEC contends that the antifraud provisions

tity, Use Offshore Accounts for Secret Stocks, supra note 125 (quoting Bill McDonald, California Department of Corporations, as stating that "[s]urveillance is a waste of time, . . . [t]here's so much [fraud] out there").

189. See Wolf & Shorr, *supra* note 126, at B12 (describing actions taken by SEC, Federal Trade Commission ("FTC"), Commodity Futures Trading Commission ("CFTC"), and U.S. Office of Consumer Affairs ("USOCA"), pertaining to Internet activities).

190. See BLACK'S LAW DICTIONARY, *supra* note 164, at 614 (defining FTC as agency of U.S. federal government created in 1914 in order to promote free and fair competition in interstate commerce through prevention of general trade restraints). Price-fixing agreements, false advertising, boycotts, illegal combinations of competitors, and other unfair methods of competition are examples of trade restraints that FTC attempts to prevent. *Id.*

191. See Wolf & Shorr, *supra* note 126, at B12 (outlining FTC's position on its regulatory scope on Internet).

192. See Knight, *supra* note 12, at D2 (explaining that majority of investment scams on Internet can be prosecuted under existing mail and wire fraud laws, however, regulators still must overcome anonymity factor).

193. See Cella & Stark, *supra* note 5, at 101 (describing SEC's position concerning securities laws' adaptation to Internet transactions).

194. See Jefferson, *supra* note 16, at 71 (interviewing Erich Schwartz, attorney with SEC's Enforcement Division, stating that SEC's "experience is that existing securities laws are adequate to address the issues and problems we're facing . . . [and although] [t]he Internet provides a new mechanism for wrongdoers, . . . in securities fraud, it's just another leaf on the same old tree"); see also Eady, *supra* note 166, at 16 (stating that in Canada, most provincial securities commissions are silent on issue of extraterritoriality of their existing securities laws).

Although the Ontario Securities Commission ("OSC") staff is presently working on drafting the Canadian policy on regulating securities on the Internet, "[i]n all likelihood, [the Canadian regulatory approach] will be similar to the SEC policies." Eady, *supra*, at 12. For the most part, Canadian regulators agree with the SEC and believe there is no need for new securities laws to handle trading activity on the Internet. See

such as Section 10(b)¹⁹⁵ and Rule 10b-5¹⁹⁶ of the 1934 Act can be applied to any electronically-transmitted information, and Section 17(b)¹⁹⁷ of the 1933 Act to the on-line distribution of reports.¹⁹⁸

b. U.S. State Regulation of Internet Securities

As a result of state regulators' concern pertaining to the Internet's lack of geographical boundaries, numerous states have consented to uniform regulations to combat Internet fraud.¹⁹⁹ Pennsylvania was the first state to create a regulatory framework for raising capital over the Internet.²⁰⁰ In August 1995, the Pennsylvania Securities Commission adopted an order ("Pennsylvania Order" or "Order") containing three rules that issuers must follow if they did not want to register and to sell securities within the state of Pennsylvania.²⁰¹ The Order requires the issuer to state that the offering is not intended for residents of Pennsylvania.²⁰² In addition, the issuer cannot have any direct

id. at 16 (stating that "[e]xisting U.S. laws and Canadian laws should be sufficient for the task").

Presently, Canadian securities laws do not recognize the Internet to be any different from other modes of communication. *Id.* at 4. The British Columbia Securities Commission, for example, holds that there is indeed legal jurisdiction within their province over the Internet if any of the elements of a transaction can be traced to the province. *Id.* at 16-17; see BCSC Notice NIN 97/9 – *Trading Securities and Providing Advice Respecting Securities on the Internet* at 2 (explaining that "[i]t is the [British Columbia Securities] Commission's view that, notwithstanding the interjurisdictional nature of communications on the Internet, the registration and prospectus requirements of the Securities Act applies only in respect of communications made by, or directed at, residents of British Columbia or persons located in British Columbia").

195. 15 U.S.C. § 78j(b) (1997).

196. 17 C.F.R. § 240.10b-5 (1996).

197. 15 U.S.C. § 77q(b) (1997).

198. See McGlosson, *supra* note 54, at 310-11 (describing application of federal securities laws to Internet).

199. See *id.* at 310 (describing NASAA's proposal to standardize regulations pertaining to new issues over Internet). *But cf.* Gregg, *supra* note 54, at 427 (explaining that national securities offering on Internet will result in regulatory burden as issuers will have to comply with fifty-one versions of disclosure requirements).

200. See Bertram, *supra* note 2, at 3 (explaining that Pennsylvania Securities Commission's order ("Pennsylvania Order" or "Order") was first response by state securities regulator regarding use of Internet for raising capital).

201. Order of the Pennsylvania Securities Commission, *In Re: Offers Effected Through the Internet That Do Not Result in Sales in Pennsylvania*, 1995 Pa. Sec. LEXIS 71 (Aug. 31, 1995) at *2.

202. *Id.*

communication with Pennsylvania residents.²⁰³ Finally, the issuer may not sell to Pennsylvania residents.²⁰⁴ If the issuer complies with all three rules, then the issuer does not have to register the securities in Pennsylvania.²⁰⁵

Other states have followed Pennsylvania's lead.²⁰⁶ Within one year of the Pennsylvania Order, nineteen other states adopted similar guidelines,²⁰⁷ stating that registration requirements within their respective states will not be necessary as long as the offering indicates that the securities are not registered in that state.²⁰⁸ Therefore, by complying with the orders, someone wishing to issue securities on the Internet is prevented from inadvertently violating state registration provisions.²⁰⁹

In January 1996, in response to the initiatives of several member jurisdictions, NASAA adopted a resolution²¹⁰ regarding the offer and sale of securities over the Internet.²¹¹ NASAA's resolution basically followed the Pennsylvania Order.²¹² NASAA then encouraged other states, which had not already adopted similar orders, to adopt similar standard regulations and registration requirements for companies wanting to issue stock over

203. *Id.*

204. *Id.*; see Bruce Rule, *State Regulators Wrestle with Internet Issues*, INVESTMENT DEALER'S DIG., Oct. 21, 1996, at 8 (describing regulations of Pennsylvania Order).

205. Order of the Pennsylvania Securities Commission, *supra* note 201, at *2.

206. Indiana Securities Division Order No. 95-0115 AO, Nov. 1995; Alaska Administration of Securities, Administrative Order No. 96-06S, Dec. 1995; Vermont Securities Division, Docket No. 96-2-SE, Jan. 1996; West Virginia Securities Division Order No. 96-0856, Apr. 1996. Similar conditions as those in the Pennsylvania Order are found in New York, Indiana, North Dakota, South Dakota, West Virginia, Alaska, Vermont, Connecticut, and other states. See *Pennsylvania Securities Commission Bulletin*, July 1996, at 1 [hereinafter *PSC Bulletin*] (explaining that other states have based their guidelines on Pennsylvania Order).

207. See *PSC Bulletin* (describing Pennsylvania Order's acceptance by state securities regulators).

208. See *id.* (explaining that orders avoid placing issuers within jurisdiction of state securities acts other than acts those states to which wish to offer and to sell).

209. See *id.* (stating that Pennsylvania Order resolves potential registration provision violations by issuers not interested in offering or selling securities in Pennsylvania).

210. See *Resolution of the North American Securities Administrators Association Regarding Offers and Sales of Securities on the Internet*, Jan. 7, 1997 (providing standardized regulatory procedure for permitting companies to offer securities on Internet).

211. See Rule, *supra* note 204, at 8 (explaining that each state commission reserves right to consider unregistered company's Internet material as offering under its jurisdiction, but each commission will exempt material from registration if company states that it is not attempting to sell securities in that state).

212. See *id.* (explaining that NASAA's resolution incorporates all three of Pennsylvania Order's rules).

the Internet.²¹³

B. Australian Approach to Regulating Securities on the Internet

Australia takes a broader approach when asserting its regulatory authority over the Internet than the United States.²¹⁴ The ASIC adopted Policy Statement 107 on Electronic Prospectuses²¹⁵ ("Policy Statement 107") as its position regarding securities trading on the Internet.²¹⁶ According to Policy Statement 107, the statutory requirements to file with the ASIC²¹⁷ applied regardless of where the offer originated, as long as the offer can be received in Australia.²¹⁸ Australian law now provides that an e-mail to Australian investors, or an offer on a foreign web site that is accessible within Australia, is subject to Australian registration requirements.²¹⁹

Although the ASIC concedes that it will grant exemptions to foreign issuers on the Internet, the ASIC still requires the issuer to indicate clearly that Australian investors will not be accepted.²²⁰ Non-Australian investors, therefore, must not only recognize those countries requiring affirmative disclosure of what countries the issuer is registered to sell in, but also must affirmatively disclose to which countries they are not directing the offer.²²¹ The ASIC, however, admittedly concedes that the

213. See *id.* (explaining that NASAA's resolution confronts most alarming aspects of Internet for regulators, lack of state and national boundaries).

214. Australian Securities Commission, *Policy Statement 107: Electronic Prospectuses* (visited May 22, 1998) <<http://www.asc.gov.au/frames/208.html>> (on file with the *Fordham International Law Journal*) [hereinafter *Policy Statement 107*] (defining ASIC's broad regulatory approach to Internet securities offerings); see HOWARD M. FRIEDMAN, *SECURITIES REGULATION IN CYBERSPACE* 8-1 (1997) (detailing statutory requirement of filing prospectus with ASIC applies "to any offer received in Australia, regardless of where the offer originates") (emphasis in original).

215. *Policy Statement 107*, *supra* note 214.

216. See FRIEDMAN, *supra* note 214, at 8-1 (noting that Policy Statement 107: Electronic Prospectuses asserts broad authority over Internet offerings).

217. *Policy Statement 107*, *supra* note 214.

218. See FRIEDMAN, *supra* note 214, at 8-2 (detailing ASIC's position on filing requirements).

219. See *id.* (describing ASIC's viewpoint on establishing contacts with Australian investors).

220. See *id.* (explaining that ASIC's exemption requirements focus on facilitating use of electronic prospectuses when investors in Australia are solicited).

221. See *id.* at 8-4 (describing ASIC's affirmative disclosure policy for Internet offerings and ASIC's willingness to work with non-Australian securities regulators for granting exemptions to issuers placing non-Australian prospectuses on Internet).

current uncertainty pertaining to securities laws on the Internet and their application by various countries is impeding the use and development of the medium as an investment tool.²²²

C. IOSCO's Position Regarding Internet Securities Transactions

Although IOSCO recognizes the need for coordinating regulators in different jurisdictions,²²³ IOSCO has only one public document²²⁴ ("IOSCO Report") addressing the Internet.²²⁵ The IOSCO Report consists of an in-depth discussion pertaining to the characteristics of the Internet, however, it does little more than recognize the Internet's capabilities in the securities industry and suggest that regulators should cooperate in enforcing judgments and implementing sanctions.²²⁶ IOSCO's Technical Committee established its own Internet Taskforce and is preparing a report due for release in September 1998 at the Annual IOSCO Conference.²²⁷ In essence, any type of international agreement for regulating securities fraud on the Internet remains undeveloped.²²⁸

III. THE NECESSITY OF AN INTERNATIONAL SOLUTION

Using the Internet is, unavoidably, a global activity. As such, U.S. federal laws, blue sky laws, or even a foreign country's laws

222. ASIC Policy: *Offers, Invitations and Advertisements of Securities on the Internet* (visited Sept. 28, 1998) <<http://www.asic.gov.au/page-477.html>> (on file with the *Fordham International Law Journal*) (discussing policy proposal establishing guidelines for Internet fundraising and encouraging adoption of Internet technology).

223. See IOSCO, *supra* note 3 (recommending that regulators recognize legitimate uses of Internet in securities industry).

224. See International Organization of Securities Commissions, *Welcome to the International Organization of Securities Commissions* (visited Sept. 2, 1998) <<http://www.iosco.org/ios-home.html>> (on file with the *Fordham International Law Journal*) (listing *Report on Enforcement Issues Raised by the Increasing Use of Electronic Networks in the Securities and Futures Field* as only public document pertaining to Internet securities).

225. See IOSCO, *supra* note 3 (suggesting that regulators need to identify challenges and to make recommendations to other securities commissions).

226. See *id.* (explaining that IOSCO report was response to Mandate on Issues Raised by Increasing Use of Electronic Networks in Securities and Futures Field).

227. Telephone Interview with Jean-Pierre Cristel, IOSCO Deputy Secretary General (Sept. 1, 1998); see *General Information on IOSCO* (visited Sept. 28, 1998) <<http://ww2.iosco.org/index2.html>> (on file with the *Fordham International Law Journal*) (listing twenty-third Annual Conference of IOSCO for September 1998, in Nairobi, Kenya). The report of IOSCO's Technical Committee, *Securities Activity on the Internet*, can be found at <http://www.iosco.org/docs-public/1998-internet_security.html>.

228. Telephone Interview with Martin Eady, *supra* note 14.

are inadequate to regulate this new medium. Regulation of securities transactions on the Internet affects a tremendous international arena²²⁹ and should be handled by a multilateral treaty rather than piecemeal, and potentially conflicting, orders and legislation. Although existing regulatory agencies are capable of addressing these problems, because of the Internet's global nature, state agencies should not police on-line activity individually. Instead, securities transaction on the Internet should be regulated on the national, or more effectively, the international level, without individual states further confusing issues of jurisdiction and the application of state laws.²³⁰

A. *Overburdening Regulations*

Purchasing securities through the Internet appears to be the investment tool of the future. Full-service firms that ignore technological advances in the industry bring about their own eventual demise.²³¹ In fact, firms that do not embrace the new technology run the risk of losing the new generation of investors who prefer to trade on-line.²³² Inevitably, the traditional broker will become obsolete and the traditional brokerage house, a ghost town.

As for state registration and regulation, it can conceivably stunt Internet usage for issuers. To establish the Internet as a viable source for issuing securities, the federal government should take sole control of the registration process and issue regulations that preempt the state securities laws. Issuers are still monitored and subject to civil liability and antifraud provisions of the federal securities laws.²³³ If state regulators are permitted to assert jurisdiction over a medium that is global in nature,²³⁴

229. See *supra* note 178 and accompanying text (explaining global nature of Internet).

230. See *supra* notes 197-209 and accompanying text (relating to state regulation of Internet).

231. See *supra* notes 42-45 and accompanying text (detailing relative ease for individuals to access information on Internet and increasing number of investors using Internet to trade securities).

232. See *supra* notes 46-48 and accompanying text (describing securities-related activities conducted on Internet).

233. See *supra* notes 193-98 and accompanying text (discussing application of existing securities laws to Internet).

234. See *supra* notes 139-40 and accompanying text (describing worldwide nature of Internet and global access that it provides for investors).

however, then the Internet will become overburdened with registration requirements and procedures,²³⁵ and these burdens will hinder the development of an effective tool for the securities industry.

B. *Conventional Rules Governing Other Mediums Are Inadequate*

Methods of detection and apprehension of on-line scam artists pose challenges for regulatory agencies²³⁶ because lawmakers could not have foreseen this technology when enacting securities laws decades ago.²³⁷ Enforcement agencies are in the precarious situation of encouraging the new technology, while at the same time finding ways to regulate it.²³⁸ Regulatory intervention, however, is necessary to control this medium to some degree and to keep a certain legitimacy to those securities transactions occurring on-line. Unfortunately, without any established international regulations, enforcement will consistently be behind the technological advances that on-line scam artists can use to their advantage.²³⁹ The conventional rules promulgated to govern other mediums of communication are simply unable to encompass Internet securities transactions.²⁴⁰ The SEC may broadly interpret its registration provision,²⁴¹ yet, even if a broker or dealer fails to register, it is extremely difficult to identify an unregistered broker or dealer.

The cooperative efforts among state regulators and other enforcement agencies are a positive step to control the medium that has virtually no state or national boundaries.²⁴² The similarity between regulations will prove useful in establishing set

235. See *supra* notes 199-205 and accompanying text (discussing regulations and requirements for Internet offerings).

236. See *supra* notes 118-22 and accompanying text (explaining difficulties in recognizing and apprehending those committing fraud over the Internet).

237. See *supra* note 122 and accompanying text (discussing that Internet technology was not foreseeable when originally drafting securities laws).

238. See *supra* text accompanying notes 112-19 (discussing Internet's dichotomy as new avenue for information and for fraud).

239. See *supra* text accompanying notes 13-16 (describing problems arising due to absence of defined regulatory standards).

240. See *supra* notes 172-82 and accompanying text (describing unresolved jurisdictional issues pertaining to Internet contacts).

241. See *supra* note 184 and accompanying text (explaining SEC's position regarding application of securities laws to Internet transactions).

242. See *supra* notes 167-71 and accompanying text (describing evaluation of contacts over medium without geographical boundaries).

guidelines and procedures for prosecutions and regulation of the Internet.²⁴³ This uniformity helps businesses wishing to raise capital over the Internet because such uniform laws will alert them of the consensus among the jurisdictions, obviating the need for cumbersome state-by-state research and registration.

Although the Pennsylvania Order and its legislative disciples appear to be a reasonable attempt for issuers to sell securities over the Internet without the burden of registering with the state, in reality such orders are simply ridden with overbroad criteria.²⁴⁴ Essentially, these orders require an issuer to register with the state if there is virtually any communication with a resident of that state, however slight.²⁴⁵ To comply with the orders' requirements, the issuer must refrain from engaging in any business pertaining to the sale of securities in that state.²⁴⁶ In essence, these orders can be viewed as simply an attempt to require any issuer to register the sale of securities and not an effort to construct a homogenous model for regulation of Internet securities transactions.

The enacted state orders can also prove harmful if non-U.S. countries were to follow similar procedures. This issue goes beyond mere securities regulation on the Internet and is actually a display of federal and state governments seeking to regulate, and possibly to punish, those contacting U.S. citizens. A dangerous international backlash may result, and, in retaliation, foreign governments may apply regulations that allow them to claim jurisdiction over a U.S. citizen. The United States would face the frightening prospect that its citizens would be punished for offending or violating foreign laws even though they are not punishable in the United States.²⁴⁷

Nevertheless, the Pennsylvania Order may prove to be a useful model in the international spectrum to the extent that it ex-

243. See *supra* notes 206-13 and accompanying text (describing other U.S. states' adoption of Pennsylvania Order and NASAA resolution).

244. See *supra* notes 199-205 and accompanying text (explaining criteria of Pennsylvania Order).

245. See *supra* notes 203-05 and accompanying text (explaining that issuers on Internet, unless registered in Pennsylvania, cannot have direct communication with Pennsylvania residents).

246. See *supra* notes 206-09 and accompanying text (addressing orders, similar to Pennsylvania's, that regulate Internet offerings and registration requirements).

247. See *supra* notes 164-66 and accompanying text (discussing choice of law issues on Internet).

plicitly addresses securities transactions on the Internet. Perhaps a policy for regulating the industry can be formed on a global level, where international agreements, possibly through an organization such as IOSCO, produce reciprocal standards for Internet investing.²⁴⁸

CONCLUSION

The Internet makes the world a smaller place, and an international regulatory policy must be established to coincide with this movement. Over-regulation of the Internet can, however, hinder and ultimately prevent new ideas and opportunities for on-line investing. Although some regulation is clearly necessary to combat Internet stock fraud, hurdles such as jurisdiction and identity impose immense burdens on regulators and give an advantage to those who commit the fraud. It is overly optimistic for regulators to rely on existing state and federal laws to regulate the Internet. The inadequacy of the current legal framework, however, does not imply that the enactment of both state and federal laws is necessary. The more legislation that is passed and the more regulations that are instituted, the more likely inconsistencies will erupt and cause inefficiency. A necessary development is an internationally-instituted policy that sets the standards and regulations for using the Internet as an investment tool. Without a multilateral agreement, jurisdictional and regulatory problems will inevitably stunt the securities industry's expansive new avenue.

248. See *supra* notes 106-09 and accompanying text (addressing IOSCO's suggestions of coordination and cooperation among securities commissions).

